INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS
JANUARY 2006

Summary:

- The Indonesian Rupiah rallied strongly in the first five weeks of 2006, reaching an eleven-month high of Rp 9,190/USD on February 7.
- Year-on-year (YoY) consumer price inflation (CPI) in January 2006 was slightly higher than expected at 17%.
- At its February 7 monetary policy meeting, Bank Indonesia (BI) left its benchmark interest rate unchanged at 12.75%.
- On January 2, Indonesia's ministers distributed 2006 budget allocations to provincial governments, avoiding the crippling multi-month delays of 2005. Aceh received the third highest regional allocation of Rp 17.5 trillion (USD 1.9 billion), the bulk of which will go toward tsunami reconstruction.
- On January 2, Coordinating Minister for Economic Affairs Boediono said the government would seek debt swaps with foreign creditors in order to reduce Indonesia's debt burden.
- On January 24, the MOF sold Rp 5.85 trillion (USD 623 million) of Rupiah bonds, its first debt auction in 2006.
- On January 30, BI issued a new banking policy package that should lower minimum reserve requirements for most banks and will delay until 2007 full implementation of BI's uniform loan classification rule, which had dramatically increased non-performing loans at some banks.
- In response to concerns about rising credit card defaults, BI issued rulings effective December 28, 2005, establishing a minimum salary to qualify for a credit card, limiting credit lines to twice monthly salary, and requiring minimum credit card payments of ten percent of outstanding debt. BI hopes to establish a credit bureau by the end of 2006.

Rupiah Strengthens to Eleven-month High

The Rupiah rallied strongly against the dollar in the first five weeks of 2006, appreciating 7% from its December 30, 2005 closing level of Rp 9,840/USD to Rp 9,190/USD on February 7. Analysts agree that a region-wide weakening of the greenback, a positive response to President Yudhoyono's new economic team, and an inflow of foreign capital seeking higher yields have fueled the Rupiah's rise. The Jakarta Stock Exchange (JSX) also enjoyed a strong month in January 2006, with the JSX composite index rising 6% to close at 1,232 on January 31. The last week of January saw a record trading volume of eight billion shares as JSX investors locked in profits. BI Deputy Governor Aslim Tadjuddin stated on January 27 that global oil prices would no longer have such a significant impact on the Rupiah/USD exchange rate due to a drop in demand for oil imports. (Note: Monthly average fuel imports are down 22% since the GOI cut fuel subsidies on October 1, 2005. End Note.) Indonesia's currency has appreciated by 28% since it hit a four-year low of Rp 11,750/USD in August 2005.

January Inflation is 17%

After easing in December, Indonesia's consumer price index (CPI) rose in January 2006 by 1.36% month-on-month (MoM) and 17.03% YoY, slightly above analysts' expectations. A 4.29% MoM increase in food prices contributed the most to the inflation rate, while transportation, communication, and financial services prices fell by 0.05% compared with the previous month.

CPI Components

Components	MoM	YoY
Food stuff	4.29	15.22
Food, beverages, tobacco, cigarettes	0.94	13.86
Housing, water, electricity, oil/gas	0.70	13.06
Clothing	0.73	7.67
Health	1.06	7.02
Education, recreation, and sport	0.20	8.38
Transportation, communication, financial services	-0.05	44.11
TOTAL	**1.36**	**17.03**

Source: Central Bureau of Statistics (BPS)

BI Leaves Interest Rate Unchanged

At its February 7 monetary policy board meeting, BI left interest rates unchanged at 12.75%, as most analysts had expected. "Inflation is under control, the banking sector is performing satisfactorily and the Rupiah is gaining strength," the media quoted the Board of Governors as saying. While it still regards inflationary pressures as high, BI estimates YoY inflation rates will drop to 8-9% by the end of 2006, compared with 17.8% in the fourth quarter of 2005. BI Governor Burhanuddin Abdullah said the bank would continue a tight monetary policy for the first half of this year. "In the third quarter, we will be rather neutral. Starting in the fourth quarter we will see if the policy can be relaxed," he said.

2006 Budget Allocations Delivered

On January 2, the MOF approved 2006 budget allocations or "DIPAs" for the country's 33 provinces. The prompt distribution of these important budget documents should remedy the multi-month delays that hampered the ability of national ministries and local governments to implement programs in 2005. Coordinating Minister for the Economy Boediono noted the 2006 budget allocations of Rp 204 trillion (USD 21.7 billion) will provide economic stimulus to all regions of Indonesia.

Cabinet ministers visited provincial capitals to present the budget distributions to local governments, which will subsequently distribute budget allocations to local spending units. "Aceh receives the third biggest allocation after Jakarta and East Java, Rp 17.5 trillion (USD 1.9 billion), for post-tsunami rehabilitation and reconstruction," State Minister for Communication and Information Sofyan A Djalil said. Sofyan said the Agency for Rehabilitation and Reconstruction of Aceh and Nias (BRR) would manage more than Rp 12 trillion (USD 1.3 billion) for Aceh with line ministries managing the remainder. Energy and Mineral Resources Minister Purnomo Yusgiantoro handed over a budget allocation of Rp 5.6 trillion (USD 596.3 million) to Bali; Trade Minister Mari Eka Pangestu presented Rp 5.4 trillion (USD 570.7 million) to West Nusa Tenggara province; Public Housing Minister M Yusril As`ari handed over Rp 5.1 trillion (USD 543 million) to Maluku province; and Religious Affairs M. Maftuh Basyuni gave Rp 6.7 trillion (USD 713.4 million) to Central Kalimantan province.

Government Seeks Debt Swaps

After opening 2006 trading at the Jakarta Stock Exchange on January 2, Coordinating Minister for Economics Boediono told the press that the GOI would seek to reduce foreign debt through debt swaps. He noted the Ministry of Finance and National Development Planning Agency are looking at various options, and that Germany, Italy, and Great Britain have expressed interest. Germany has already swapped some debt with Indonesia in exchange for promised spending on education and the environment. The GOI aims to reduce Indonesia's foreign debt-to-GDP ratio from the current 22.7% to 12.6% by 2009. Indonesia's total debt-to-GDP ratio, including Rupiah denominated bonds, is currently 49.1%.

First Domestic Bond Auction of 2006

On January 24, Indonesia sold Rp 5.85 trillion (USD 622.9 million) of domestic Rupiah bonds, the first sovereign debt auction of 2006. The MOF sold Rp 3.8 trillion (USD 404.6 million) of seven-year Treasury bonds maturing March 15, 2013 and Rp 2.05 trillion (USD 218.3 million) of 15-year bonds maturing June 15, 2021. The seven and 15-year bonds offered yields of 12.9 and 13.3% respectively. The 2006 budget calls for net GOI bond issuance to reach Rp 24.9 trillion (USD 2.6 billion) in 2006, or 0.8% of GDP this year.

Bank Indonesia Announces New Policy Package

During his annual policy speech on January 13, BI Governor Burhanuddin Abdullah announced a nine-point policy package for the banking industry, including a much-awaited revision of BI's minimum reserve requirement. BI subsequently issued the regulations on January 30 and will implement them gradually throughout 2006. Under its reserve requirements, BI requires banks to deposit an amount equivalent to 5-8% of their capital with BI to soak up excess funds and curb speculative foreign exchange trading. Although the requirement has helped create monetary stability, it has limited bank lending. BI adjusts the minimum reserve requirement depending on a bank's loan-to-deposit ratio. Abdullah noted that BI could lower minimum reserve requirements later in 2006 if macroeconomic conditions permit.

BI also announced it would delay enforcement of its "uniform loan collectibility classification" rule, which will give banks more time to address problem loans before they must report them as non-performing. The regulation requires multiple lenders to the same borrower or project to apply the lowest collectibility classification assigned by any lender. Thus, if a borrower misses payments to one creditor resulting in a downgrade of the loan, other creditors must re-classify the loan at the same, lower level.

Under the January 2006 revisions, BI will now require banks to apply the uniform loan classification standards only to their top 50 borrowers or to loans of Rp 25 billion (USD 2.7 million) or greater. BI will then lower this ceiling to Rp 10 billion (USD 1.1 million) in the six months, and Rp 5 billion (USD 530,000) in 12 months. BI has stated that it may delay implementation of the standards for loans of Rp 500 million (USD 53,000) or greater until mid-2007. BI has admitted it will not have the tools to effectively enforce uniform loan classification standards until it has completed a better system to monitor creditworthiness of borrowers and track loan defaults. BI hopes to have a credit bureau established by the end of 2006, which may assist in this goal.

The banking sector has complained about the uniform loan classification standards since BI first introduced them in July 2005, arguing that they would force a dramatic increase in non-performing loans (NPLs). The regulation dramatically affected Bank Mandiri, Indonesia's largest bank. Mandiri's net NPLs doubled to 15% in mid-2005 after it reclassified its loan portfolio in accordance with the uniform standards.

Bank Indonesia Issues New Credit Card Regulations

Concerned about growing consumer credit card debt and default, BI issued a new ruling effective December 28, 2005 requiring a minimum salary of three times the local minimum wage to qualify for a credit card. Banks must also limit the maximum line of credit to twice a cardholder's monthly salary. An additional ruling in November 2005 requires banks to ensure cardholders pay a minimum monthly payment of ten percent of outstanding debt. The Indonesian Consumer Foundation and Indonesian Association of Credit Card Issuers hope the new rules will enhance consumer protection and prudential lending by banks. As of August 2005, credit card defaults were Rp 1.08 trillion (USD 115 million), or 7.17% of total credit card debt. For issuers, the new ruling may result in slower consumer lending. As a consequence, some banks have revised their estimates for consumer loan growth in 2006. Banks issuing credit cards in Indonesia charge very high interest rates annualized at about 26–42% (2.2–3.5% per month)

<u>Selected Economic, Monetary & Financial Statistics</u>

	Oct 05	**Nov 05**	**Dec 05**	**Jan 06**
CPI Inflation (YoY)	17.89	18.38	17.11	17.03
CPI Inflation (MoM)	8.70	1.31	-0.04	1.36
Rp/USD Exchange rate [1]	10,090	10,035	9,840	9,392
30-day SBI Interest Rate [2]	11.0	12.25	12.75	12.75
Foreign reserves [3]	32.5	33.1	34.1	35.1
JSX Composite Index	1066.2	1096.6	1162.6	1232.3
JSX Trans Volume [4]	1,260	878		
Exports (USD billion)	7.76	6.83	8.09	
% Change (YoY)	*19.51*	*18.98*	*19.53*	
Import (USD billion)	4.79	4.04	4.79	
% Change (YoY)	*29.13*	*26.80*	*23.69*	
Trade Balance [5]	2.97	2.79	3.30	

Source: Bank Indonesia, BPS

(1) Rp/USD, end of period

(2) End of period

(3) USD billions, end of period

(4) Jakarta Stock Exchange average daily transaction volume, in billions of shares

(5) USD billions

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